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No. 88-1337

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

HERMAN SOIFER,

Petitioner,

—v.—

BANKERS TRUST COMPANY, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

JOEL W. STERNMAN
(*Counsel of Record*)

AUDRY WEINTROB
ROSENMAN & COLIN
575 Madison Avenue
New York, New York 10022
(212) 940-8800

Attorneys for Petitioner
Herman Soifer

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I. BAC, AS DEBTOR IN POSSESSION, IS SUBJECT TO THE PERVASIVE CONTROL OF THE BANKRUPTCY COURT AND CANNOT PROPERLY BE VIEWED AS CONTROLLED BY THE ALLEGED WRONGDOERS

The foundation of Bankers' efforts to support its standing to assert a creditor's RICO claim rests on a critically flawed premise. In Bankers' view, because no trustee has been appointed, the alleged wrongdoers from whom it seeks to recover remain in control of BAC.

Nearly 50 years ago, this Court made clear that a debtor in possession becomes subject to the pervasive control of the bankruptcy court and that, as a result, it is no longer free to act, as it could have acted before the filing of its petition, in the self-interest of its management or equity holders. Instead, a debtor in possession must act consistently with its fiduciary obligations to its creditors.

As stated in *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U.S. 106, 125 (1939), a company which "invokes the aid" of the bankruptcy courts "assumes all of the consequences which flow from that jurisdiction". While former management may continue to operate the company's business, it does so subject to conditions prescribed by the bankruptcy court:

> Thus, while the property remains in the hands of the court, as it does until dismissal or final decree on confirmation, the debtor, though left in possession by the judge, does not operate it, as it did before the filing of the petition, unfettered and without restraint. The control of the court is then pervasive. . . . The right to remain in unmolested dominion and control over the property was necessarily waived or abandoned on invoking the jurisdiction of the federal courts in these proceedings. When that jurisdiction attached, the court rather than the shareholders was in control. . . . 308 U.S. at 125-26, 127.

See also Pepper v. Litton, 308 U.S. 295, 307 (1939).

These same principles are reflected in section 342 of the former Bankruptcy Act, 11 U.S.C. § 742 (1976):

> Where no receiver or trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this title, subject, however, at all times to the control of the court and to such limitations, restrictions, terms, and conditions as the court may from time to time prescribe.[1]

See generally 8 *Collier on Bankruptcy* ¶ 6.32[1] at 929 (14th ed. 1978):

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1 BAC's bankruptcy proceeding was commenced prior to October 1979. As a result, it is subject to the former Bankruptcy Act. *See* Pub. L. 95-598, § 403(a), 92 Stat. 2549 at 2683 (1978). The present Bankruptcy Code has not modified the principles governing the duties of a debtor in possession. *See* 11 U.S.C. § 1107(a).

> [A] debtor in possession, in addition to his duty to exercise his powers for the benefit of creditors, is under a duty to preserve and protect his title and to maintain his possession for the benefit of creditors.

In *Commodity Futures Trading Comm. v. Weintraub*, 471 U.S. 343, 355 (1985), this Court described the obligations imposed on a debtor in possession as follows:

> [B]ankruptcy causes fundamental changes in the nature of corporate relationships. One of the painful facts of bankruptcy is that the interests of shareholders become subjected to the interests of creditors. . . .
>
> [I]f a debtor remains in possession—that is, if a trustee is not appointed—the debtor's directors bear essentially the fiduciary obligation to creditors and shareholders as would the trustee for a debtor out of possession. *Wolf v. Weinstein*, 372 U.S. 633, 649-52 (1963). Indeed, the willingness of courts to leave debtors in possession "is premised upon an assumption that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee." *Id.*, at 651.

See also Stein v. United Artists Corp., 691 F.2d 885, 892 (9th Cir. 1982):

> The debtor in possession is strictly supervised by the bankruptcy court, and his actions, including abandonment, must be approved. The bankrupt does not act in his own interests until he reverts to his former status upon discharge and confirmation of the plan. The extent of the fiduciary duties should not vary with the identity of the one who performs that role.

Against this backdrop, Bankers' attempt to cast BAC as the alter ego of the alleged wrongdoers must be rejected. Because it is a debtor in possession subject to the pervasive control of the bankruptcy court, BAC cannot, as a matter of law, be viewed as an entity "still controlled by the individual racketeers" and a

"tool of the racketeering enterprise—which here is still controlled by the racketeers". Bankers' Br. at 7, 16.

Moreover, no one has "conceded" that BAC is "under the continuing control" of the alleged wrongdoers. Bankers' Br. at 12. Surprisingly, Bankers claims to find support for this alleged concession in the District Court's 1987 decision rejecting Bankers' attempt to assert a creditor's RICO claim. *Id.*, citing 676 F. Supp. at 503; App. 36a. However, after referring to Bankers' contention that BAC's daily affairs are managed by the alleged wrongdoers, the District Court stated as follows:

> Nevertheless, BAC's reorganization is still pending before the bankruptcy court. Consequently, Bankers can move the bankruptcy court to appoint a trustee. This would enable the trustee to sue to recover the misappropriated assets on behalf of BAC and all of BAC's creditors, thereby ensuring an equitable distribution. If the trustee fails to bring such an action, then Bankers could treat the claim as abandoned and could bring an action on its own behalf without threatening the principles underlying the Bankruptcy Code. *See Mitchell Excavators, Inc. v. Mitchell*, 734 F.2d 129, 131 (2d Cir. 1984). As long as the bankruptcy case is open and Bankers is able to recover on its claim through the process of equitable distribution, however, a suit under RICO against BAC's corporate officers is inappropriate. 676 F. Supp. at 503; App. 36a-37a.

In any event, even if BAC was under the control of the alleged wrongdoers, Bankers still could not pursue its loss of a legitimate debt claim without authorization from the bankruptcy court. As noted in the Petition (at 10 n. 7), individual creditor claims must, in the first instance, be pursued through the bankruptcy court. The situation here parallels that which arises when creditors attempt to pursue claims they believe have been abandoned by a trustee. Absent bankruptcy court authorization, those attempts will be rejected. *See*, *Dallas Cabana, Inc. v. Hyatt Corp.*, 441 F.2d 865, 868 (5th Cir. 1971):

> The failure of the trustee to assert a cause of action against the appellees in this case is not sufficient to authorize this

> court to hold that the action has been abandoned and that, therefore, this appellant has a right to maintain it. The remedy of the appellant is to petition the bankruptcy court to compel the trustee to bring suit or to authorize the bankrupt to sue or to make such disposition as appears to be appropriate in the circumstances and under the facts presented to the court. Without such authorization or clear manifestation of the trustee to abandon the claim, or some other disposition as the lower court may deem appropriate, appellant may not maintain this cause of action.

See also Nebraska State Bank v. Jones, 846 F.2d 477, 478 (8th Cir. 1988) (*per curiam*):

> Where no trustee has been appointed and the debtor in possession has not exercised its avoidance powers, a dissatisfied creditor has several options:
>
> > the creditor may move to replace the debtor-in-possession with a Chapter 11 trustee; or to convert the Chapter 11 case to one under Chapter 7; move to dismiss the Chapter 11 case; or petition the court to compel the debtor-in-possession to act or to gain court permission to institute the action itself.
>
> (Citation omitted). Appellant failed to pursue any of these options; we will not assume, as appellant does, the futility of doing so.

Bankers cannot excuse its failure to seek relief from the bankruptcy court by references to unspecified "adroit manipulation of the Bankruptcy Court procedure" and acts characterized as having "made a mockery of Bankers' conventional bankruptcy remedies." Bankers' Br. at 13, 16. Its arrogant refusal to seek relief from the bankruptcy court is inexcusable.[2]

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2 *See* 566 F. Supp. at 1236, 1242 n. 10, where, in dismissing Bankers' original complaint in 1983, the District Court referred to but did not

Bankers' ill-conceived theory, under which the debtor in possession and the pre-filing debtor are equated, must be rejected. In its place, BAC, as debtor in possession, should properly be viewed as a representative of all creditor interests, including Bankers, obligated to fulfill fiduciary responsibilities and subject to the control of the bankruptcy court. Viewed in this light, BAC as debtor in possession has the same duties and responsibilities as a bankruptcy trustee. It also has the exclusive right to pursue or ignore claims such as Bankers' loss of a legitimate debt claim unless Bankers can persuade the bankruptcy court to order otherwise.

Practically all of Bankers' distinctions of the cases relied on by petitioner derive from the erroneous premise that, because no trustee has been appointed, BAC remains under the control of the alleged wrongdoers. *See, e.g.*, Bankers' Br. at 11-13, discussing *Dana Molded Products, Inc. v. Brodner*, 58 B.R. 576 (N.D. Ill. 1986) and *Barnett v. Stern*, 93 B.R. 962 (N.D. Ill. 1988) (distinction based on trustees having been appointed); *Mitsubishi Electric Sales America Inc. v. Higgins*, 1988 WL 124756 (N.D. Ill. 1988) (distinction based on absence of allegation that defendants controlled the debtor); *National Enterprises Inc. v. Mellon Fin. Serv. Corp. No. 7*, 847 F.2d 251 (5th Cir. 1988) (distinction based on trustee's pursuit of claims against same parties).

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reach petitioner's argument that Bankers' claim could only be asserted in the BAC bankruptcy proceeding. Petitioner continued its challenge to Bankers' standing in opposing Bankers' 1984 petition for the issuance of a writ of certiorari following the Second Circuit's affirmance of that dismissal. *See* Brief of Respondent Herman Soifer, filed with this Court in November 1984 (No. 84-657), at 24. Since Bankers became aware of petitioner's challenge to its standing in 1983, it has actively participated in the BAC bankruptcy proceeding. *See, e.g., In re Braten Apparel Corp.*, 68 B.R. 955 (Bankr. S.D.N.Y. 1987) (adjudicating certain claims of Bankers against the BAC estate). Despite that participation, and the fact that the BAC bankruptcy proceeding remains pending as of this date, Bankers has refused to seek authorization from the bankruptcy court to pursue its loss of a legitimate debt claim.

Nor does the fact that other creditors of BAC have not pursued claims for relief provide any justification for Bankers' cavalier decision to bypass the bankruptcy court for six years—despite its belief that the bankruptcy court would be incapable of preventing further wrongdoing, Bankers cannot create standing otherwise unavailable to it. Its right to redress for any alleged injustice permitted by the bankruptcy court lies in appeals to the District Court and the Court of Appeals.

For nearly seven years, Bankers has refused to pursue rights available to it in the BAC bankruptcy proceeding and has not provided any persuasive explanation for its failure to do so. Its speculation as to the bankruptcy court's impotence cannot justify its disregard of procedures designed to protect the rights of all creditors.

Bankers' citation to RICO's legislative history (Br. at 16) shows that Congress was aware of problems relating to bankruptcy "bust-outs,"[3] not that it intended to authorize individual creditors to circumvent an existing bankruptcy proceeding. Indeed Congress later, in 1978, made a technical amendment to 18 U.S.C. § 1961(1) to conform the language of that section with the language of the new Bankruptcy Code. Bankruptcy Reform Act of 1978, § 314(g), P.L. 95-598, 92 Stat. 2549 at 2677. It is doubtful that Congress, in enacting the new Code (which provided expansive powers for bankruptcy courts), sought to change existing law so radically as to permit creditors to assert individual RICO claims without, at a minimum, securing prior leave of the bankruptcy court.

Nor can Bankers (Br. at 11) find support in *Sutliff, Inc.* v. *Donovan Cos.*, 727 F.2d 648 (7th Cir. 1984), where the Seventh Circuit decided only whether Sutliff and its creditors adequately alleged that they had suffered a RICO injury as a consequence

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3 A "bust-out" is a form of commercial fraud whereby criminals operate an apparently flourishing wholesale business which gradually accumulates a large inventory. Suddenly, the operators dispose of that inventory below market prices, driving the business into bankruptcy and leaving "the mulcted creditors . . . to pick over the meatless carcass of an assetless enterprise." *United States* v. *Crockett*, 534 F.2d 589, 592 (5th Cir. 1976).

of a "bust-out." The issue whether individual creditors had standing and could bypass the bankruptcy court and the rights of other creditors was neither raised by any party nor addressed by that Court.

* * *

Any consideration of Bankers' standing to bring an independent RICO action should begin with the principle that all actions involving a debtor's affairs must, to the greatest degree possible, be concentrated in the hands of a representative authorized by the bankruptcy court to protect the interests of all creditors. The objective of all bankruptcy law is the fair and equitable distribution of a debtor's assets for the benefit of its creditors, as well as orderly administration of its affairs.

In the circumstances here, Bankers may not bring an independent RICO action without necessarily disrupting the administration of the BAC estate and prejudicing the rights of BAC's other creditors. The complexity of the bankruptcy issues which surround Bankers' claim should, in the first instance, be addressed in the BAC bankruptcy proceeding. Through consensual plans of reorganization, liquidation, substantive consolidation or other procedures specified by the bankruptcy laws, the relative rights and liabilities of persons interested in the BAC estate can be fairly adjudicated.

II. THE ACCRUAL OF CIVIL RICO CLAIMS AND THE APPLICABILITY OF THE SPECULATIVE DAMAGES EXCEPTION TO RICO PRESENT IMPORTANT QUESTIONS OF FEDERAL LAW WHICH SHOULD BE DECIDED BY THIS COURT

Bankers does not challenge the express conflict between the decision below and the decision of the Third Circuit in *Keystone Insurance Co.* v. *Houghton*, 863 F.2d 1125 (3d Cir. 1988). Nor does it challenge the importance, previously recognized in *Agency Holding Corp.* v. *Malley-Duff & Associates, Inc.*, ____ U.S. ____, 107 S.Ct. 2759 (1987), of establishing a uniform rule to govern the accrual of civil RICO claims. Instead, it asserts

(Br. at 18) that petitioner was not "aggrieved" by application of the rule of separate accrual.

Bankers' assertion is without any merit. *First*, no authority requires a petitioner to be aggrieved by each aspect of the decision presented for review. *Second*, the rule of separate accrual, when combined with the speculative damages exception, aggrieves petitioner by reviving a time-barred claim and permitting it to remain in a legal limbo for an indeterminate period. Regardless of whether petitioner is aggrieved by application of the rule of separate accrual, the issue presented should be reviewed by this Court.

The absence of a conflict in the Circuits is not dispositive of petitioner's right to certiorari on the applicability of the speculative damages exception to civil RICO actions. That question is an important one which should be settled by this Court.

Bankers fails to point to any reason why a narrow doctrine designed to address a problem in certain types of antitrust litigation rationally should be extended to support some misguided rough justice when RICO and the bankruptcy laws collide. Similarly, even assuming the applicability of the speculative damages exception to RICO, Bankers fails to address how that doctrine could apply in situations similar to those here. As shown in the Petition, courts seeking to determine whether a claim should be dismissed as time-barred may consider whether, if the claim had been bought at an earlier date, it would have been subject to dismissal because of uncertainty that the underlying wrongdoing would in fact have deprived plaintiff of future lost profits. The speculative damages exception was developed to avoid dismissals on limitations grounds of claims based on wrongdoing which, when committed, did not cause any immediate damages.

No parallel exists between the uncertain existence of any future lost profits and situations where a recovery in one action might reduce a recovery in another action. Bankers has known of the maximum amount it could recover since 1976. Uncertainty as to its source—distributions to creditors of the BAC estate or a favorable judgment in this action—is irrelevant and

has nothing to do with the existence of damages and the accrual of claims, the issues addressed by the speculative damages exception.

Statutes of limitation should not lightly be ignored nor should judicially-created doctrines such as the speculative damages exception be extended in an irrational way to compartmentalize in different time-frames claims for relief which have accrued at the same time. Any standing which Bankers had to pursue its loss of a legitimate debt claim has existed since 1976, when that claim accrued. The fact that its pursuit would have interfered with the orderly administration of the BAC estate cannot justify an artificial deferral of its accrual.

The Second Circuit failed to recognize that, whatever the merit to its underlying claims, the passage of time has deprived Bankers of whatever opportunity it may have had to seek relief for its alleged injuries.

For the foregoing reasons, Bankers' arguments in opposition to the petition for a writ of certiorari should be rejected and the the writ should issue.

Dated: New York, New York
March 24, 1989

JOEL W. STERNMAN
(Counsel of Record)

AUDRY WEINTROB
ROSENMAN & COLIN
575 Madison Avenue
New York, New York 10022
(212) 940-8800

Attorneys for Petitioner
Herman Soifer